

MANAGEMENT'S DISCUSSION AND ANALYSIS

(unaudited)

As management of Chesterfield County (County), we offer readers of the County's financial statements this narrative overview and analysis of the financial activities of the County for the fiscal year ended June 30, 2003. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal at the front of this report and the County's financial statements, which follow this analysis.

FINANCIAL HIGHLIGHTS

- ◆ The County's total net assets increased approximately \$76.5 million (8.0%). Net assets of the governmental-type activities increased \$46.7 million (12.2%) and net assets of the business-type activities increased \$29.8 million (5.2%).
- ◆ The County's unrestricted net assets increased approximately \$3.7 million (1.8%). Unrestricted net assets of the governmental-type activities increased \$9.6 million (14.5%) and unrestricted net assets of the business-type activities decreased \$5.9 million (4.3%).
- ◆ The County's program and general revenues (including taxes) of \$575.4 million for governmental-type activities (excluding transfers) exceeded expenses of \$529.4 million by \$46.0 million.
- ◆ In the County's business-type activities, revenues increased 1.5% to \$76.8 million while expenses decreased by 1.9% to \$46.3 million (excluding transfers).
- ◆ The total cost of the County's primary government's programs increased approximately \$33.3 million (6.1%) to \$575.7 million.
- ◆ The General Fund reported an ending fund balance amount of \$103.8 million, a decrease of \$9.6 million (8.4%) in comparison with the prior year. Of the ending fund balance amount, \$42.3 million was unreserved and undesignated.
- ◆ The County's outstanding debt decreased by \$9.9 million (2.4%). General obligation refunding bonds were issued in the amount of \$32.4 million, Virginia Public School Authority (VPSA) bonds were issued in the amount of \$24.0 million and certificates of participation were issued in the amount of \$6.1 million. The principal payments on and the defeasement of existing debt exceeded the effect of issuing new debt resulting in reduced outstanding debt when compared to the prior year.

OVERVIEW OF THE FINANCIAL STATEMENTS

The County's Comprehensive Annual Financial Report (CAFR) consists of four sections: introductory, financial, statistical, and compliance. The financial section consists of five components – the independent auditors' report, management's discussion and analysis (this component), the financial statements, required supplementary information, and supplementary information. The financial statements include two categories of statements that present different views of the County:

- ◆ The first two statements are government-wide financial statements that provide a broad overview of both long-term and short-term information of the County's financial status.
- ◆ The remaining statements are fund financial statements that focus on individual parts of the County government and report the County's operations in more detail than the government-wide statements:
 - Governmental fund statements tell how general government services, such as public safety, are financed in the short-term as well as what resources remain for future spending.
 - Proprietary fund statements offer both short-term and long-term financial information about activities the government operates like private-sector businesses, such as the water and wastewater systems.
 - Fiduciary fund statements provide information about the financial relationships, such as the supplemental retirement plan for certain qualified County employees, in which the County acts solely as a trustee or agent for resources belonging to others.

The notes, a component of the financial statements, provide additional details for understanding the information presented in the CAFR. The notes are followed by a section of required supplementary information that further explains and supports the pension plan information reported in the financial statements. The CAFR also includes a supplementary section containing combining schedules for the non-major governmental funds, the agency funds and the internal service funds, additional schedules and School Board component unit fund schedules.

Government-wide Statements

The government-wide statements report information about the County as a whole using accounting methods similar to those used by private-sector businesses. The statement of net assets includes all of the government's assets and liabilities, both short-term and long-term. The statement of activities reports all of the current year's revenues and expenses as soon as the underlying event for recognition occurs, regardless of the timing of the related cash flows. The government-wide statements report the County's net assets and how they have changed. Net assets, the difference between the County's assets and liabilities, is a measure of the County's financial health, or position:

- ◆ Over time, increases or decreases in the County's net assets are an indicator of whether its financial health is improving or deteriorating, respectively.
- ◆ To assess the overall health of the County, CAFR users should consider additional nonfinancial factors such as changes in the County's property tax base.

The government-wide financial statements of the County are divided into three categories:

- ◆ Governmental activities – Most of the County's basic services, such as police, fire, social services, parks and recreation, and general administration, are included in governmental activities. Property taxes and state and federal funding finance the majority of these activities' expenses.
- ◆ Business-type activities – Activities that are intended to recover all or a significant portion of their costs through user fee charges to external parties for goods or services are included in the business-type activities.
- ◆ Component units – The County includes two other entities in its report: the School Board and the Health Center Commission. Although legally separate, these component units are presented because of the County's financial accountability for them.

Fund Financial Statements

The fund financial statements provide more detailed information about the County's major funds and not the County as a whole. Funds are accounting devices that the County uses to track resources that are segregated for specific activities or objectives. Some funds are required by State law or by bond covenants. Other funds are established to control and manage money for particular purposes or to show that the County is using certain taxes and grants for their intended purposes.

The County has three kinds of funds:

- ◆ Governmental funds – Most of the County's basic services are included in governmental funds which focus on (1) how cash and other financial assets that are readily convertible to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the statements for governmental funds provide a detailed short-term view that assists the CAFR reader in determining the status of financial resources available for financing the County's programs in the near future. Because this information does not encompass the additional long-term focus of the government-wide statements, the County provides additional information, either at the bottom of the governmental funds statement or on the following page, that explains the differences between the short-term and long-term focus.
- ◆ Proprietary funds – Services that are intended to recover all or a significant portion of their costs through user fees are reported in proprietary funds. Proprietary fund financial statements, like the government-wide statements, provide both long and short-term financial information and they also provide additional details and information, such as the statement of cash flows. The County's enterprise funds are reported in the business-type activities of the government-wide statements because these funds generally provide services to customers external to the County. The internal service funds are reported in the governmental-type activities of the government-wide statements because those funds provide supplies and services internally to the County's other programs and activities.
- ◆ Fiduciary funds – The County is responsible, as trustee, for the assets of various trust and agency funds that can be used only for the fiduciary beneficiaries. The County is responsible for ensuring that the assets reported in these funds are used for their intended purposes. All of the County's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. These activities are excluded from the County's government-wide financial statements because the County cannot use fiduciary assets to finance its operations.

FINANCIAL ANALYSIS OF THE COUNTY AS A WHOLE

Net assets. The County's assets exceeded liabilities by \$1.0 billion at the close of the most recent fiscal year. This represents an 8.0% increase over the prior year.

TABLE 1
Chesterfield County's Net Assets
(in millions of dollars)

| | Governmental Activities | | Business-type Activities | | Total Primary Government | | School Board Component Unit | |
|--|------------------------------------|------------------------|-------------------------------------|------------------------|-------------------------------------|--------------------------|--|----------------------|
| | <u>2002</u> | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> | <u>2003</u> |
| Assets | | | | | | | | |
| Current and other assets | \$ 287.0 | \$ 314.8 | \$ 180.2 | \$ 196.2 | \$ 467.2 | \$ 511.0 | \$ 73.3 | \$ 52.7 |
| Capital assets | <u>643.1</u> | <u>672.2</u> | <u>460.2</u> | <u>468.7</u> | <u>1,103.3</u> | <u>1,140.9</u> | <u>12.4</u> | <u>12.9</u> |
| Total assets | <u>930.1</u> | <u>987.0</u> | <u>640.4</u> | <u>664.9</u> | <u>1,570.5</u> | <u>1,651.9</u> | <u>85.7</u> | <u>65.6</u> |
| Liabilities | | | | | | | | |
| Long-term liabilities | 405.4 | 403.7 | 36.6 | 31.4 | 442.0 | 435.1 | 12.0 | 16.1 |
| Other liabilities | <u>141.9</u> | <u>153.8</u> | <u>28.8</u> | <u>28.7</u> | <u>170.7</u> | <u>182.5</u> | <u>45.9</u> | <u>40.7</u> |
| Total liabilities | <u>547.3</u> | <u>557.5</u> | <u>65.4</u> | <u>60.1</u> | <u>612.7</u> | <u>617.6</u> | <u>57.9</u> | <u>56.8</u> |
| Net assets | | | | | | | | |
| Invested in capital assets, net of related debt | 306.1 | 341.1 | 425.7 | 439.3 | 731.8 | 780.4 | 12.4 | 12.9 |
| Restricted | 10.4 | 12.5 | 10.9 | 33.0 | 21.3 | 45.5 | 22.1 | 3.9 |
| Unrestricted (deficit) | <u>66.3</u> | <u>75.9</u> | <u>138.4</u> | <u>132.5</u> | <u>204.7</u> | <u>208.4</u> | <u>(6.7)</u> | <u>(8.0)</u> |
| Total net assets | <u>\$ 382.8</u> | <u>\$ 429.5</u> | <u>\$ 575.0</u> | <u>\$ 604.8</u> | <u>\$ 957.8</u> | <u>\$ 1,034.3</u> | <u>\$ 27.8</u> | <u>\$ 8.8</u> |

At the end of both the current and prior fiscal years, the County reported positive balances in all three categories of net assets, both for the primary government as a whole, as well as for its separate governmental and business-type activities. The largest portion (75.5%) of the County's net assets at June 30, 2003, is its investment in capital assets (e.g. land, buildings, machinery, equipment and infrastructure), less accumulated depreciation and any debt used to acquire those assets that remains outstanding at year-end. The County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the County's investment in its capital assets is reported net of related debt, it should be noted that the resources required to repay the debt must be provided from other sources because capital assets are not generally liquidated for the purpose of retiring debt. An additional portion of the County's net assets (4.4%) represents resources that are subject to external restrictions on how they may be used. The remaining balance is referred to as unrestricted net assets (20.1%). Unrestricted net assets are available to meet the County's ongoing obligations to citizens and creditors.

School Board component unit assets exceeded liabilities by \$8.8 million at the end of the current fiscal year. This represents a decrease of \$19.0 million (68.3%) compared to the prior year (See Table 1). The decrease in net assets of the School Board component unit is primarily due to the County's decision, effective July 1, 2002, to move the School Board's Capital Projects Fund to the primary government for reporting purposes. This decision was based on the County's charter which states that title to all real property of the school system is vested in the County and on the fact that assets purchased or constructed through this fund are financed primarily by proceeds from long-term debt. According to the code of the Commonwealth of Virginia (State), the School Board is not allowed to issue debt and, therefore, the County must issue debt on behalf of the School Board. Reporting the School Board Capital Projects Fund in the primary government eliminates the transactions necessary to move real property assets and debt proceeds between the County and the School Board. We believe that this reporting change provides information that is more meaningful because it eliminates the reporting of transactions that may be viewed as record keeping in nature and without economic basis. Daily operations of the School Capital Projects Fund remain under the control of the School Board component unit. The amount of School Capital Projects Fund net assets reported in the primary government as of July 1, 2002, was \$17.4 million. The School Board reported a deficit unrestricted

net assets of \$8.0 million mainly due to funding liabilities related to judgments, claims, and compensated absences of \$16.1 million on a pay as you go basis.

Changes in net assets. The County's total revenues (excluding special item and transfers) increased over the prior year by 1.8% to \$652.2 million. (See Table 2). The total cost of all programs increased by 6.1% to \$575.7 million. (See Table 2).

TABLE 2
Changes in Chesterfield County's Net Assets
(in millions of dollars)

| | <u>Governmental Activities</u> | | <u>Business-type Activities</u> | | <u>Total Primary Government</u> | | <u>School Board Component Unit</u> | |
|--|------------------------------------|------------------------|-------------------------------------|------------------------|-------------------------------------|--------------------------|--|----------------------|
| | <u>2002</u> | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> | <u>2003</u> |
| Revenues: | | | | | | | | |
| Program revenues: | | | | | | | | |
| Charges for services | \$ 40.4 | \$ 44.5 | \$ 45.7 | \$ 45.8 | \$ 86.1 | \$ 90.3 | \$ 13.3 | \$ 13.1 |
| Operating grants and contributions | 82.0 | 73.4 | - | - | 82.0 | 73.4 | 49.7 | 51.6 |
| Capital grants and contributions | 3.8 | 8.1 | 25.7 | 28.3 | 29.5 | 36.4 | 1.5 | - |
| General revenues: | | | | | | | | |
| Property taxes | 223.2 | 237.1 | - | - | 223.2 | 237.1 | - | - |
| Other taxes | 73.9 | 79.7 | - | - | 73.9 | 79.7 | - | - |
| Payment from School Board | 92.3 | 83.4 | - | - | 92.3 | 83.4 | - | - |
| Payment from County | - | - | - | - | - | - | 228.3 | 248.7 |
| Grants and contributions not restricted to specific programs | 46.5 | 46.9 | - | - | 46.5 | 46.9 | 98.7 | 114.8 |
| Other | <u>3.1</u> | <u>2.3</u> | <u>4.3</u> | <u>2.7</u> | <u>7.4</u> | <u>5.0</u> | <u>1.3</u> | <u>0.5</u> |
| Total revenues | <u>565.2</u> | <u>575.4</u> | <u>75.7</u> | <u>76.8</u> | <u>640.9</u> | <u>652.2</u> | <u>392.8</u> | <u>428.7</u> |
| Expenses: | | | | | | | | |
| General government | 32.5 | 38.0 | - | - | 32.5 | 38.0 | - | - |
| Administration of justice | 10.1 | 8.0 | - | - | 10.1 | 8.0 | - | - |
| Public safety | 96.1 | 103.2 | - | - | 96.1 | 103.2 | - | - |
| Public works | 19.0 | 20.9 | - | - | 19.0 | 20.9 | - | - |
| Health and welfare | 52.9 | 47.2 | - | - | 52.9 | 47.2 | - | - |
| Parks, recreation and culture | 17.5 | 18.4 | - | - | 17.5 | 18.4 | - | - |
| Education - School Board | 238.2 | 264.3 | - | - | 238.2 | 264.3 | 428.6 | 447.7 |
| Community development | 10.8 | 12.5 | - | - | 10.8 | 12.5 | - | - |
| Interest on long-term debt | 18.1 | 16.9 | - | - | 18.1 | 16.9 | - | - |
| Airport | - | - | 1.1 | 1.2 | 1.1 | 1.2 | - | - |
| Water | - | - | 22.7 | 22.1 | 22.7 | 22.1 | - | - |
| Wastewater | - | - | 23.4 | 23.0 | 23.4 | 23.0 | - | - |
| Total expenses | <u>495.2</u> | <u>529.4</u> | <u>47.2</u> | <u>46.3</u> | <u>542.4</u> | <u>575.7</u> | <u>428.6</u> | <u>447.7</u> |
| Increase (decrease) in net assets before transfers and special item | 70.0 | 46.0 | 28.5 | 30.5 | 98.5 | 76.5 | (35.8) | (19.0) |
| Special item | 1.2 | - | - | - | 1.2 | - | - | - |
| Transfers | <u>1.0</u> | <u>0.7</u> | <u>(1.0)</u> | <u>(0.7)</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Increase (decrease) in net assets | 72.2 | 46.7 | 27.5 | 29.8 | 99.7 | 76.5 | (35.8) | (19.0) |
| Net assets - July 1 | <u>310.6</u> | <u>382.8</u> | <u>547.5</u> | <u>575.0</u> | <u>858.1</u> | <u>957.8</u> | <u>63.6</u> | <u>27.8</u> |
| Net assets - June 30 | <u>\$ 382.8</u> | <u>\$ 429.5</u> | <u>\$ 575.0</u> | <u>\$ 604.8</u> | <u>\$ 957.8</u> | <u>\$ 1,034.3</u> | <u>\$ 27.8</u> | <u>\$ 8.8</u> |

Approximately 36% of the County's revenues came from property taxes and approximately 12% comes from other taxes. Another 24% of the total revenue came from grants and contributions. The remaining revenues are charges for services, payment from School Board, investment earnings and miscellaneous (See Figure A-1). The County's expenses cover a range of services with 72% related to public safety, health and welfare and education (See Figure A-2). Program revenues of the County's governmental activities covered 24% of its expenses.

Figure A-1
Chesterfield County
Sources of Revenue for Fiscal Year 2003

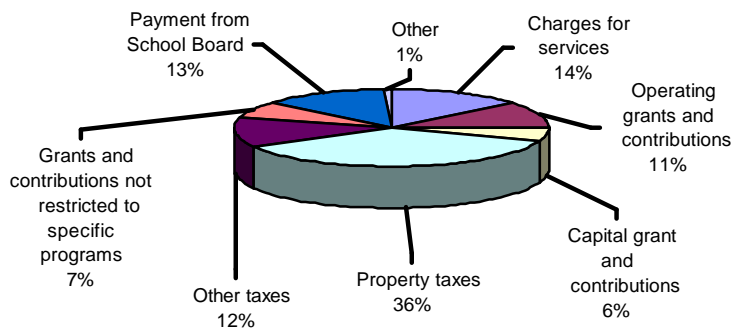
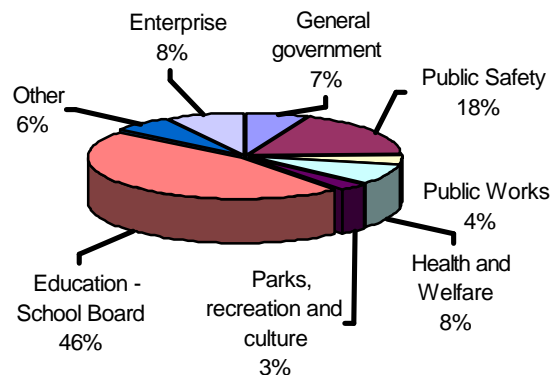


Figure A-2
Chesterfield County
Functional Expenses for Fiscal Year 2003



The School Board's total revenues increased compared to the prior year by 9.1% to \$428.7 million. The total expenses of all school programs and services increased over the prior year by 4.5% to \$447.7 million. Program revenues of School Board activities covered 14.5% of its expenses.

Governmental Activities

Governmental activities increased the County's net assets by \$46.7 million and accounted for 61.0% of the total growth in the net assets of the County. Revenues for governmental activities increased \$10.2 million (1.8%) and total expenses increased \$34.2 million (6.9%) when compared to the prior year. Key elements of these changes are as follows:

- ◆ Overall, property tax revenues increased by \$13.9 million (6.2%) during the year. This increase is due to a 6.5% increase in the assessed valuation of taxable real and personal property over the preceding year. Real property's assessed valuation increased 8.3% over the last fiscal year. Of the real property increase, 37.8% is due to new residential construction, 8.6% is due to new commercial/industrial construction, and 53.6% is due to revaluation and changes of existing properties. Commercial and industrial property comprised 21.7% of the total real property taxable value. The real estate tax rate was reduced by one-cent to \$1.07 per \$100 of assessed value by the Board of Supervisors in April 2002, effective for the real estate payment due June 5, 2002. The reduced rate was in effect for all of current fiscal year. Limited growth of 1.6% in personal property values resulted from a small increase in older model vehicles being traded for newer ones and in vehicles moving to the County. The Personal Property Tax Relief Act of 1998 (PPTRA) provides for the State to reimburse localities a portion of the personal property tax levied on the first \$20,000 of personal use cars, motorcycles, and trucks. For tax years 2003 and 2002, the reimbursement rate was 70%. The State requires localities to record the revenue from PPTRA as received from other governments, not as property taxes. When the State reimbursement is added back to property taxes, there is an increase of \$14.7 million (5.6%) over the prior fiscal year.
- ◆ The payment from School Board decreased by \$8.9 million (9.6%) over the prior year. The escrow payment of \$24.9 million related to the refunding of the 1993 series general obligation bonds and the payment of \$17.4 in net assets of the School Board's Capital Projects Fund to the School Capital Projects Fund of the primary government occurred in 2003. In the prior year, \$51.7 million in real property capital assets were purchased by the School Board and transferred to the primary government in accordance with the County charter. The remaining difference of \$0.5 million is attributable to an increase in the debt service related to debt issued by the County on behalf of the School Board.

- ◆ Overall expenses increased by \$34.2 million (6.9%). Functional categories experienced increases or decreases compared to the prior year. The Education – School Board function increased by \$26.1 million (11.0%) due mostly to the difference between the \$25.1 million in refunding bonds issued on the School Board’s behalf in 2003 and the \$16.2 million issued for the School Board’s Capital Projects Fund in 2002 and to an increase of \$17.1 million provided to the School Board for operating and maintenance costs. Public safety programs experienced increased expenses while health and welfare programs experienced decreased expenses during the year.

Business-type Activities

Business-type activities increased the County’s net assets by \$29.8 million, accounting for 39.0% of the total growth in the net assets of the County. Revenues for business-type activities increased \$1.1 million (1.5%) and total expenses decreased by \$0.9 million (1.9%) when compared to the prior year. Key elements contributing to these results are as follows:

- ◆ Charges for services for the water and wastewater operations decreased slightly over the prior year because of water usage restrictions related to the prolonged drought that the region experienced during the first part of the fiscal year.
- ◆ Capital grants and contributions for business-type activities increased overall by \$2.6 million (10.1%). Water connection fees increased \$0.9 million and developer contributions of water pipelines increased \$0.8 million in the current year compared to the prior year due to increased connection activity and an increase in connection fees. Wastewater connection fees were unchanged from the prior year. Developer contribution of wastewater pipelines decreased \$0.7 million while wastewater pipelines contributions from special assessment districts increased \$1.5 million.
- ◆ Investment earnings and unrealized gains on investments of business-type activities decreased by \$1.6 million (37.2%) due to lower interest rates.
- ◆ Contractual services for water decreased by \$0.6 million due to decreased water purchases from the City of Richmond and the Appomattox River Water Authority.
- ◆ Repairs and maintenance for water increased by \$0.2 million mainly due to an emergency repair to a large section of waterline.
- ◆ Material and supplies of the wastewater activity decreased by \$0.5 million because of continued restrictions on non-capital equipment purchases that were implemented during the prior fiscal year.

School Board Activities

School Board activities decreased its net assets by \$19.0 million (68.3%). Key elements of these changes are as follows:

- ◆ Total revenues increased overall primarily due to the payment from Chesterfield County increasing by \$20.4 million (8.9%). There was more debt issued on behalf of the School Board for refunding purposes in the current year than the amount of debt issued in the prior year to fund the School Board’s Capital Projects Fund. This year, the County provided \$25.1 million to the School Board for the refunding of general obligation debt that was issued on behalf of the School Board in 1993 and \$2.9 million in equipment purchased by the County’s School Capital Projects Fund. Last year, the County provided capital project funding of \$15.8 million from a general obligation debt issue and \$4.6 million from the General Fund. This increase in funding is in addition to an increase of \$12.8 million provided to the School Board for expenditures of the School Board Operating Fund. Grants and contributions not restricted to specific programs increased \$16.1 million (16.3%) due to receiving additional State Standards of Quality funding which resulted from an increase in student average daily membership.
- ◆ Expenses increased by \$19.1 million (4.5%) mainly due to increases of \$22.9 million in instructional expenses, \$3.9 in pupil transportation expenses, and \$3.3 in operations and maintenance expenses. Debt service expenses increased by \$25.1 due to the refunding of existing debt. In the prior year, the School Board Capital Projects Fund gave the County \$56.5 million in capital assets. In the current year, the activity of the School Board Capital Projects Fund and its beginning net assets balance of \$17.4 million were reported in the County’s School Capital Projects Fund.

FINANCIAL ANALYSIS OF THE COUNTY’S FUNDS

Governmental Funds

The focus of the County’s governmental funds is to provide information on near-term inflows and outflows and the balance of resources available for spending. Such information is useful in assessing the County’s financing requirements. In particular, unreserved, undesignated fund balance may serve as a useful measure of a government’s net resources available for spending at the end of the fiscal year.

As the County completed the year, its governmental funds reported a combined fund balance of \$146.6 million, an increase of \$14.7 million compared to the previous year. \$57.1 million (39.0%) of this amount constitutes unreserved fund

balance, of which \$42.3 million is available for governmental spending and \$14.8 million is designated by management for tentative spending plans. The remainder of fund balance is reserved to indicate that it is not available for new spending.

The General Fund is the operating fund of the County. At the end of the current fiscal year, unreserved fund balance of the General Fund was \$57.0 million and total fund balance was \$103.8 million. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 11.2% of total General Fund expenditures. Of unreserved fund balance, the undesignated amount of \$42.3 million represents 8.3% of total General Fund expenditures and exceeds the Board of Supervisors' target of 7.5%. Total fund balance represents 20.4% of General Fund expenditures.

Fund balance of the General Fund decreased by \$9.6 million during the current fiscal year. Key factors in this change are as follows:

- ◆ Real estate tax revenues increased by \$15.4 million (9.3%) due to the increase of 8.3% in the assessed valuation of taxable real property. The real estate tax rate was reduced by one-cent to \$1.07 per \$100 of assessed value by the Board of Supervisors in April 2002, effective for the real estate payment due June 5th in the prior fiscal year. The reduced rate was in effect for all of the current fiscal year. Other general property tax revenues decreased \$0.2 million, mainly due to a decrease of \$0.6 million in the machinery and tools taxes that were a result of decreased assessments and a \$0.4 million increase in penalties and interest for late tax payments. Including the PPTRA reimbursement from the State, current tax collections were 96.98% of the total tax levy, an increase from the prior fiscal year's current tax collections of 96.17%. Total tax collections as a percent of total tax levy increased from 98.63% in the prior fiscal year to 99.91% in the current fiscal year.
- ◆ Investment earnings and unrealized gain on investments decreased by \$1.3 million (44.3%) due to declining interest rates in the current year.
- ◆ Charges for services increased \$3.0 million (16.0%) primarily due to the implementation of a revenue recovery ordinance in the current fiscal year which allows the County to recover certain expenses related to emergency medical services including response and transport (\$2.0 million). New fees implemented in the current fiscal year accounted for the remaining increase and include courtroom security fees, document reproduction fees and fees to recover the County's cost of responding to accidents caused by individuals driving while intoxicated.
- ◆ Revenue from other governments decreased \$6.1 million (5.3%) mainly due to the federal food stamps program (\$6.0 million) that in prior years was recorded as revenue by the County. Beginning in May 2002, this amount was paid directly to food stamp recipients by the federal government.
- ◆ Public safety expenditures increased by \$8.4 million (9.6%). Fire department expenditures were up \$3.0 million over last year mainly due to staffing and operating a new fire station, adding firefighter positions at three existing fire stations, adding two paramedics to the medflight program and staffing a new quick response emergency medical system vehicle. Juvenile Detention Home expenses increased \$0.8 million (46.2%) due to a capacity increase from thirty-two to ninety beds, almost tripling the staff required to maintain staff to juvenile ratio requirements. Police department expenditures increased by \$3.1 million (9.8%) mainly due to implementation of the first full year of the public safety compensation plan approved by the Board of Supervisors in FY2002 and an increase in maintenance and support costs related to the upgraded emergency communications system.
- ◆ Health and welfare expenditures decreased by \$6.4 million (13.8%). The change in the federal food stamp program in the current year reduced expenditures by \$6.0 million. The payment to the Health Center Commission (HCC) component unit decreased by \$1.8 million because the HCC did not require funding for ongoing operations in the current year.

At year-end, the County's Capital Projects Fund had a total fund balance of \$17.3 million, of which \$9.6 million was reserved for encumbered contracts underway and \$7.6 million was reserved to pay future costs associated with County capital projects. The School Capital Projects Fund had a total fund balance of \$24.3 million, of which \$4.7 million was reserved for encumbered contracts underway and \$19.6 million was reserved to pay future costs associated with School capital projects.

General Fund Budgetary Highlights

The overall difference between the original budget and the amended budget for revenues and other financing sources reflected an increase of \$4.8 million (1.0%). However, budget adjustments were made to various revenue sources and some of the major changes are summarized as follows:

- ◆ The budget for general property taxes decreased by \$2.0 million due to a decrease in personal property taxes of \$2.0 million as a result of declining trends in new and used car registrations for the first six months of the year.

- ◆ The budget for other governments decreased by \$5.8 million and included a reduction of \$6.0 million for the federal food stamp program, a reduction of \$2.5 million for lower than expected state sales taxes resulting from the continued downturn in regional sales activity and an increase of \$2.0 million for PPTRA reimbursements of personal property taxes.
- ◆ The budget for permits, privilege fees and regulatory licenses increased by \$0.4 million mainly due to a \$0.3 million increase in planning and planning review fees. This increase was the first phase of a three-year plan to increase planning fee revenue with a goal of recovering 80% of the cost of development review activities by the third year.
- ◆ The budget for charges for services increased by \$1.9 million due to greater than anticipated emergency medical service transports and subscriptions of \$0.8 million, \$0.2 million in courtroom security fees and a \$0.6 increase in mental health and mental retardation fees.
- ◆ The budget for recovered costs increased by \$1.0 million mainly due to receiving \$1.1 million from the Riverside Regional Jail Authority (RRJA) as a refund for per diem payments made by the County as a participating locality. RRJA generated these excess funds by selling beds to federal agencies, contracting with the State to hold inmates under the Jail Contract Bed program, and selling beds to non-member jurisdictions.
- ◆ The original budget for other financing sources increased by \$8.0 million reflecting the decision during the year to sell bonds to refund existing debt.

The final amended budget for expenditures and other financing uses was greater than the original budget by \$50.3 million (10.4%). The increase in expenditure appropriations can be summarized as follows:

- ◆ The budget for transfers out increased by \$41.4 million. The budget for the transfers to the County Capital Projects Fund and the School Capital Projects Fund increased by \$27.7 million and \$28.4 million, respectively, mainly due to the appropriation of prior year construction reserves.
- ◆ The budget for the public safety function increased by \$3.7 million mainly due to increases in the fire and sheriff and jail operations. A \$1.4 million increase in the fire department budget was a result of appropriating additional revenue recovery program funds to cover the cost of planned system enhancements and donations to volunteer rescue squads. A \$2.2 million increase in jail operations budget covered additional expenditures (\$1.7 million) incurred due to higher than expected increases in the average jail population of inmates held at the regional jail. The average jail population increased from 445 in the prior year to an approximately 475 in the current year. In addition, the budget for the Sheriff and local jail required an additional appropriation of \$0.5 million due primarily to higher than expected medical/health services expenses that were incurred for inmates.
- ◆ The original budget for other financing uses increased by \$8.0 million reflecting the decision during the year to sell bonds to refund existing debt.

Actual revenues and other financing sources exceeded the amended budget by \$2.3 million. Increased assessed values of real property resulted in an increase of \$4.8 million in real estate taxes. Lower than expected personal property taxes and PPTRA reimbursements from the State resulted in a \$4.1 million difference of actual to amended budget. Machinery and tools taxes were \$0.7 million lower than expected due to a dispute with a large industrial taxpayer. Penalties and interest collections exceeded the amended budget by \$0.9 million. Other local taxes collected exceeded the amended budget by \$3.7 million: \$1.7 million in recordation taxes due to strong real estate market and low interest rates; \$1.1 million in local sales and use taxes because retail sales in the region increased overall by about 1.4%; and \$1.7 million in consumer utility taxes for which unseasonable temperatures (electric and gas) and rate changes made the budget for these revenue sources difficult to predict. The amended budget for categorical aid from the State exceeded actual revenues by \$1.2 million mainly attributable to a decrease in State funding of the juvenile probation function.

Actual expenditures and other financing uses were \$49.3 million less than the amended budget amount and no legal level of budgetary control was exceeded. Of this amount, \$34.8 million is because less than budgeted amounts were transferred out to other funds. The transfer to the School Board accounted for \$6.1 million less than the budgeted amount due to lower than expected categorical aid from the State that passes through the County and with less spending on capital and maintenance projects throughout the fiscal year. The transfer to the County Capital Projects Fund had \$28.3 million less than the budgeted amount due to not transferring all construction reserves. Other expenditure savings can be attributed to the County requiring departments to implement cost saving measures to offset decreased funding from the State and the limited growth of local revenues due to the slow down in the economy. This spending reduction plan was accomplished by a County wide reduction in travel and capital purchases as well as from delayed filling of vacant non-essential positions; however, the budget was not adjusted to reflect the reductions.

CAPITAL ASSET AND DEBT ADMINISTRATION

Overview

Governmental Accounting Standards Board Statement 34 requires the issuing entity to report “on behalf” debt and debt service. The operational relationship between the County and School Board component unit related to capital assets and debt involves several transactions between the two entities that are presented in the statements to meet reporting requirements. Brief descriptions of those transactions are:

- ◆ The School Board can neither levy taxes nor incur debt under Virginia law. The County issues debt “on behalf” of the School Board, which is recorded as a liability of the County’s governmental activities. In prior years, proceeds from new debt issued “on behalf” of the School Board were recorded in the County’s General Fund and an amount equal to the proceeds received was then provided to the School Board’s Capital Projects Fund to pay for capital expenditures. In the current year, this amount was recorded in the School Capital Projects Fund of the primary government. In both the prior and current years, proceeds from debt issued to refund existing debt issued “on behalf” of the School Board was recorded in the County’s General Fund and an amount equal to the proceeds received from refunding was then provided to School Board operations for the purpose of funding the retirement of existing debt.
- ◆ The County’s charter states that title to all real property of the school system shall be vested in the County of Chesterfield. The County provides the School Capital Projects Fund with funding to purchase and/or construct real property (land, buildings, improvements other than buildings, and construction in progress) for use in school operations. Due to the charter, the value associated with the purchase and/or construction of School Board real property is reported as capital assets in the governmental activities of the County. Depreciation and accumulated depreciation related to School Board real property is reported in the County’s governmental activities within the appropriate government-wide statements.
- ◆ The County’s budgeting process provides for the School Board component unit to receive funding from the County. The School Board is responsible for allocating funding to cover debt service related to “on behalf” debt and is presented as debt service on the School Board’s statement of revenues, expenditures, and changes in fund balance – budget and actual. However, for the statement of revenues, expenditures, and changes in fund balance, the School Board presents a payment to the primary government in an amount to cover debt service payments and payments to escrow agents.

Capital Assets

At the end of the fiscal year, the County had invested \$1.1 billion in a broad range of capital assets, including public safety buildings, park facilities, libraries, and water and wastewater lines. (See Table 3). This amount represents a net increase of \$37.6 million (3.4%) over the prior year.

TABLE 3
Chesterfield County's Capital Assets
(net of depreciation, in millions of dollars)

| | Governmental Activities | | Business-type Activities | | Total | | Total Percentage Change |
|-----------------------------------|------------------------------------|-----------------|-------------------------------------|-----------------|-------------------|-------------------|--|
| | 2002 | 2003 | 2002 | 2003 | 2002 | 2003 | 2002-2003 |
| Non-depreciable assets: | | | | | | | |
| Land | \$ 33.0 | \$ 33.6 | \$ 3.1 | \$ 3.2 | \$ 36.1 | \$ 36.8 | 1.9% |
| Construction in progress | 141.8 | 29.0 | 11.8 | 6.3 | 153.6 | 35.3 | (77.0%) |
| Depreciable assets: | | | | | | | |
| Buildings | 378.4 | 519.8 | 92.9 | 97.4 | 471.3 | 617.2 | 31.0% |
| Improvements other than buildings | 20.3 | 21.7 | 19.7 | 19.6 | 40.0 | 41.3 | 3.2% |
| Machinery and equipment | 49.1 | 46.5 | 332.7 | 342.2 | 381.8 | 388.7 | 1.8% |
| Infrastructure | 20.5 | 21.6 | - | - | 20.5 | 21.6 | 5.4% |
| Total | \$ 643.1 | \$ 672.2 | \$ 460.2 | \$ 468.7 | \$ 1,103.3 | \$ 1,140.9 | 3.4% |

This year's major capital asset additions and decreases in construction in progress included:

- ◆ Completion of the juvenile detention center - \$14.9 million
- ◆ Completion of the Winterpock fire station - \$2.8 million
- ◆ Completion of various park improvements - \$1.6 million
- ◆ Completion of School projects: Chester Middle School renovations - \$10.2 million; Meadowbrook High School renovations - \$34.6 million; Thomas Dale High School renovations - \$31.3 million; Matoaca High School \$47.3 million
- ◆ For business-type activities: the Midlothian water tank project - \$4.5 million; upgrades to pump stations - \$3.0 million; and the Great Branch Tributary sewer line - \$2.0 million

The amount of capital assets (net of accumulated depreciation) used by the School Board in its operations was \$402.7 million of the total value of capital assets of the governmental activities.

The County's fiscal year 2004 capital budget projects spending \$105.7 million for capital projects, which includes \$81.1 million for the primary government and \$24.6 million for the School Board. Principal projects for the primary government include a Community Development building, parks improvements, emergency systems integration, jail replacement, financial/human resource system, water lines and upgrades to wastewater pump stations. School projects are principally for school building additions and improvements. The County plans to issue additional debt to finance these and future projects as identified in the Capital Improvement Program 2004-2010. More detailed information about the County's capital assets is presented in Note 8 to the financial statements.

Long-term Debt

At year-end the County had \$406.4 million in bonds and leases outstanding, a decrease of 2.4% compared to last year (See Table 4). More detailed information about the County's long-term liabilities is presented in Note 9 to the financial statements.

The County issued new debt during the year totaling \$24.0 million in general obligation bonds (VPSA), \$23.4 million for School Board projects and \$0.6 million for parks and recreation projects. To take advantage of lower interest rates, the County issued \$32.4 million of general obligation refunding bonds to advance refund \$31.6 million of outstanding 1993 bonds. By refinancing the debt, the County reduced its debt service payments by \$2.7 million over the next eight years and obtained an economic gain of \$2.6 million. The County also issued \$6.1 million in certificates of participation for final funding of the juvenile detention home project and for jail renovation and construction.

TABLE 4
Chesterfield County's Outstanding Debt
(in millions of dollars)

| | Governmental Activities | | Business-type Activities | | Total | | Total Percentage Change |
|---|------------------------------------|------------------------|-------------------------------------|-----------------------|------------------------|------------------------|--|
| | <u>2002</u> | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002-2003</u> |
| General obligation bonds, net (backed by the County) | \$ 341.9 | \$ 336.2 | \$ - | \$ - | \$ 341.9 | \$ 336.2 | (1.7%) |
| Revenue bonds, net (backed by fee revenues) | - | - | 39.0 | 32.1 | 39.0 | 32.1 | (17.7%) |
| State literary fund loans | 6.4 | 4.9 | - | - | 6.4 | 4.9 | (23.4%) |
| Capital leases | <u>28.6</u> | <u>32.8</u> | <u>0.4</u> | <u>0.4</u> | <u>29.0</u> | <u>33.2</u> | 14.5% |
| Total | <u>\$ 376.9</u> | <u>\$ 373.9</u> | <u>\$ 39.4</u> | <u>\$ 32.5</u> | <u>\$ 416.3</u> | <u>\$ 406.4</u> | (2.4%) |

The amount of "on behalf" debt outstanding related to School Board activities is \$271.2 million of the total outstanding debt of the governmental activities.

A key debt policy established by the County's Board of Supervisors is the ratio of debt service costs to general government expenditures, which was 8.0% for the current year comparing favorably to the policy target of 10%.

The County's financial standing and management practices have resulted in the award of an Aaa bond rating from Moody's Investors Service, an AAA bond rating from Fitch Investors Service Inc., and an AAA from Standard & Poor's Corporation for general obligation bonds and water and sewer revenue refunding bonds.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The County's unemployment rate rose from 2.5% in 2001 to 3.0 % in 2002, and was 3.1% in July 2003. Chesterfield's 2002 unemployment rate of 3.0% was still below the State's 4.1% unemployment rate for the same period. The statewide rise in unemployment has contributed to a decrease in state individual income tax revenues, the major source of funds for the state government, and has resulted in cuts in the State's budget for FY2003 and FY2004. Declines in the region's economic status have also led to less growth in sales and personal property taxes and to decreases in interest revenue for Chesterfield County.

The development of the FY2004 budget was challenging. The continued sluggish national and state economy, combined with budget reductions and unfunded commitments from the State, have significantly impacted the County's ability to maintain existing services levels. Every attempt has been made to minimize the effects of such reductions. While growth in the budget continues, local taxes per capita remain consistent with FY2003 indicating continued efficiency in the County's ability to deliver services. As a result, the FY2004 adopted budget projects both conservative revenue and expenditure growth. The FY2004 adopted General Fund budget equals \$525.5 million and represents a 2.1% increase over the FY2003 adopted budget of \$514.7 million. The FY2003 original budget presented on the budget and actual statements of the financial section of the CAFR includes adjustments (i.e. encumbrances, etc.) and therefore, will not calculate to the ratio increase of 2.1% for the FY2004 adopted budget mentioned above.

Several factors have impacted the revenue available for the FY2004 budget. Reductions in State funding have had significant impact because State revenues comprise approximately 20% of the General Fund budget. The FY2004 budget projects State funding reductions totaling in excess of \$6.1 million resulting in reductions in the areas of administration of justice, public safety, health and welfare and libraries. The real estate tax rate remains constant at \$1.07 per \$100 of assessed value on real property. The budget also includes a second phased in increase in the fees paid for residential development review, a new \$1,000 fee for resubmission of previously approved subdivision plans and a new \$400 burn permit fee for open burning of large volumes of debris material.

The FY2004 budget for utilities includes an increase in the water connection fee. For FY2004, the fourth and final \$250 increase in water connection fees was phased in to increase this fee to \$3,592 effective July 1, 2003. This increase will be used to fund the expansion of the Appomattox River Water Authority water treatment plant to provide additional capacity. The water and wastewater rates will increase 4.7% and 2.9%, respectively, and are necessary to fund \$10.0 million in additional replacement projects for water capacity and \$17.0 million in nutrient removal facilities at wastewater treatment plants necessary to remain compliant with Chesapeake Bay Program requirements.

Difficult choices have been made as the FY2004 budget was developed, and it represents a balance between available resources and needs. This balance was achieved using the objectives and priorities established by the Board of Supervisors and it is consistent with established countywide strategic goals.

CONTACTING THE COUNTY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the County's finances and to demonstrate the County's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Chesterfield County Accounting Department, 9400 Lori Road, Chesterfield, Virginia 23832.